CTBA | Center for Tax and Budget Accountability

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FACT SHEET
Creating a Graduated Income Tax

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What is a Graduated Income Tax?

A flat income tax structure assesses one tax rate for all taxpayers, regardless of income. Unlike a flat tax, a graduated income tax structure assesses greater tax rates on greater levels of income. A graduated rate structure allows an income tax to adjust its burden in accordance with ability to pay. Thus, it helps create a fair tax system, by imposing a greater tax burden on affluent, than on low and middle income families, when tax burden is measured as a percentage of income.

Why does Illinois need a Graduated Income Tax Structure?

- The answer is simple, the lack of a graduated income tax rate structure makes the state's tax system unfair and unsustainable, while hurting the Illinois economy.
- Creating a graduated income tax structure would help remedy both the unfairness and unsustainability of Illinois' tax structure. Consider fairness first:
    - Of all the different ways to tax (sales, property, excise, etc.), the income tax is the fairest because it is the only tax which increases or decreases automatically in accordance with ability to pay. If a taxpayer receives a raise, his or her income tax liability will increase. If on the other hand a taxpayer loses his or her job, income tax liability will decrease.
- The current Illinois tax system is the opposite of fair, because it places the greatest burden on low and middle income families. Indeed Illinois presently has the third highest tax burden for low income families of all 50 states.[1] Consequently, as shown in Figure A, the tax burden of the lowest 20percent of income earners is more than double that of the top 1 percent.

	Bottom 80%				Top 20%		
Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Income	Less than $18,000	$18,000 – $36,000	$36,000 – $58,000	$58,000 – $95,000	$95,000 – $196,000	$196,000– $500,000	$500,000 or more
Average Income in Group	$10,100	$26,600	$47,000	$74,700	$128,900	$300,700	$2,084,700
Sales & Excise Taxes	6.90%	5.50%	4.40%	3.60%	2.70%	1.70%	0.80%
Property Taxes	4.80%	3.60%	3.70%	3.70%	3.90%	3.10%	1.50%
Income Taxes	2.00%	3.20%	3.90%	4.00%	4.10%	4.10%	4.20%
TOTAL TAXES	13.70%	12.30%	12.00%	11.40%	10.70%	8.90%	6.50%
Federal Deduction Offset	–0.0%	–0.1%	–0.4%	–0.7%	–1.1%	–0.8%	–1.2%
TOTAL AFTER OFFSET	13.70%	12.20%	11.60%	10.70%	9.50%	8.00%	5.30%

Figure A

- This makesthe Illinois tax structure regressive. A regressive system is unfair because it does not impose tax burden in a manner that corresponds with ability to pay.
- A regressive tax system is also unsustainable, since it does not respond to how income growth gets distributed over time in the modern economy. By not responding to modern economic growth patterns, it fails to generate adequate yearly revenue to maintain service levels, creating deficits even when service levels remain constant from year to year.
- Regressive tax policy also hurts the Illinois economy because it directly reduces consumer spending, which accounts for over 66 percent of the state's economy. By imposing a significant tax burden on low and middle income families, Illinois is reducing the amount of money these families actually have to spend. These families are our best consumers

because they have a high marginal propensity to consume, simply meaning they spend their pay because they can't afford to save.

How to Establish a Graduated Income Tax Structure in Illinois

- The Illinois Constitution prohibits lawmakers from setting marginal income tax rates at different amounts for different levels of income.[2]
- It also makes Illinois a tax outlier. In fact, **of the 41 states with an individual income tax, all but seven have graduated rate structures**. [3]
- Hence, Illinois needs a constitutional amendment to implement a graduated income tax structure.

How coulda Graduated Income Tax Structure Impact Illinois Taxpayers?

- If Illinois passed a constitutional amendment permitting the creation of a graduated income tax system, it could be structured to generate the following beneficial outcomes:
- **Cut the overall state income taxburdenfor 94 percent of all taxpayers**—that means on average**, taxpayers with under $150,000 in annual base income would receive a tax cut, as shown in Figure B**;
- Despite shifting tax burden to affluent taxpayers, nonetheless keep **the effective state income tax rate, (what they really pay) for millionaires at just 4.3 percent of income.**
- **Raise at least $2.4 billion annually in new revenue** to help eliminate ongoing structural deficits in the state's General Fund; and
- **Stimulate the growth of at least 36,000 jobs in the state's private sector** through enhanced public and consumer spending.

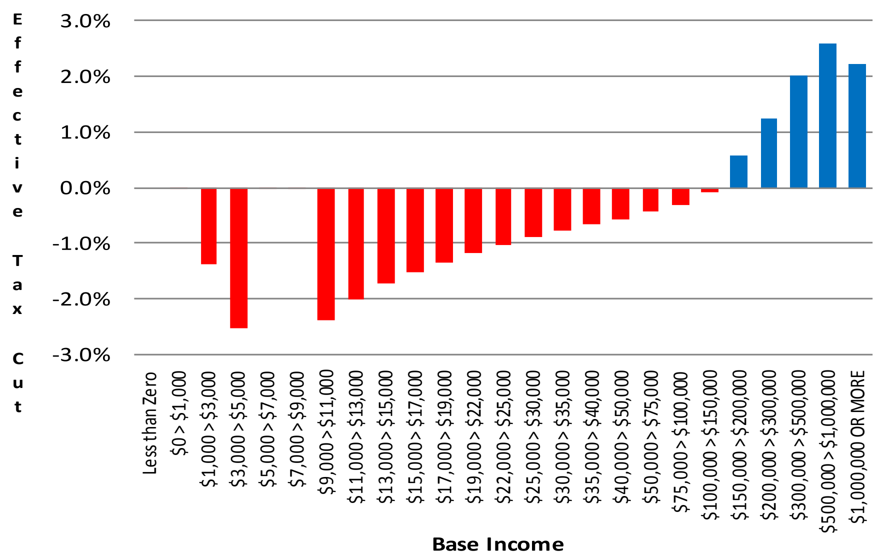

Figure B

Conclusion

Currently, Illinois tax policy is neither fair to taxpayers nor designed to sustain funding current service levels into the future. It also reduces consumer spending which in turn hurts Illinois' economy. With a graduated income tax structure, Illinois can create a fairer tax system while also raising revenue to pay its bills, stimulate the economy, and fund vital public services. Now is the time to act. In 2015, the temporary income tax increase passed in 2011 will begin being phased out, yet Illinois will still need to fund necessary public services as well as pay current and past bills. Why not implement a tax reform that not only raises the revenue needed to pay bills but also taxes people fairly?

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[1]Institute on Taxation and Economic Policy (ITEP). "Who Pays? A Distributional Analysis of the Tax Systems in All 50 states, 3rd Edition" November 2009. p.42. The only states with a higher state and local tax burden on the Lowest 20% of families are Washington and Florida, neither of which have a state personal income tax.

[2]Illinois Constitution Article IX, Section 3(a)

[3] Federation of Tax Administrators. "State Personal Income Taxes." February, 2011